

Message Text

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ACTION EB-07

INFO OCT-01 EUR-12 EA-09 ISO-00 AID-05 CIAE-00 COME-00

FRB-01 INR-07 NSAE-00 USIA-15 TRSE-00 XMB-04 OPIC-06

SP-02 CIEP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15

STR-04 CEA-01 AGR-10 FEA-01 INT-05 /118 W

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R 141745Z AUG 75

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 3811

INFO AMEMBASSY BONN

AMEMBASSY OTTAWA

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY THE HAGUE

AMEMBASSY TOKYO

USMISSION EC BRUSSELS

USMISSION OECD PARIS

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DEPARTMENT PASS TREASURY AND FRB

E.O. 11652:N/A

TAGS: ECON, EFIN, UK

SUBJECT: INDUSTRIAL PRODUCTION -- NEAR TERM OUTLOOK

REF: (A) STATE 180524; (B) LONDON 1653

1. EMBASSY BELIEVES THAT THE CURRENT DECLINE IN INDUSTRIAL PRODUCTION WILL BOTTOM OUT DURING THE FOURTH QUARTER OF 1975 WITH A MODEST EXPORT LED RECOVERY BEGINNING DURING THE FIRST QUARTER OF 1976.

2. THIS ESTIMATE IS BASED ON THE FOLLOWING ASSUMPTIONS:

A. THE GOVERNMENT'S ANTI-INFLATION PROGRAM SUCCEEDS BOTH IN REDUCING THE RATE OF PRICE INFLATION TO

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ABOUT 10 PERCENT BY THE THIRD QUARTER OF 1976 AND

IN HOLDING WAGE SETTLEMENTS TO AN AVERAGE INCREASE OF 10 TO 12 PERCENT OVER THE SAME PERIOD.

B. NO DETERIORATION IN THE TERMS OF TRADE.

C. AN INCREASE IN WORLD TRADE AS ECONOMIC ACTIVITY RISES PARTICULARLY IN THE US, FRANCE, GERMANY AND JAPAN

D. NO UNEXPECTED EXTERNAL SHOCKS SUCH AS A MAJOR INCREASE IN WORLD COMMODITY PRICES, PARTICULARLY OIL.

3. WITH NEARLY ALL SECTORS EXPECTED TO BE OPERATING AT WELL BELOW CAPACITY DURING MUCH OF THE NEXT YEAR, THE KEY DETERMINANT IN ESTIMATING INDUSTRIAL PRODUCTION WILL BE THE LEVEL OF DEMAND. THE GOVERNMENT'S ANTI-INFLATION PROGRAM VIRTUALLY RULES OUT A CONSUMER GENERATED INCREASE IN DEMAND. THEREFORE, THE MAIN STIMULUS WILL HAVE TO COME FROM INCREASED DEMAND FOR UK EXPORTS. THIS IS EXPECTED TO DEVELOP OVER THE NEXT 6 TO 12 MONTHS AS SIGNS OF QUICKENING ECONOMIC ACTIVITY, FIRST IN THE US BUT ALSO IN WEST GERMANY, FRANCE AND JAPAN ARE TRANSLATED INTO HIGHER IMPORTS. TWO FACTORS SHOULD CONTRIBUTE TO BRITAIN'S ABILITY TO MEET THIS DEMAND. FIRST, CONTROLS ON DOMESTIC DEMAND WILL FREE RESOURCES FOR DIVERSION TO EXPORT INDUSTRIES. SECOND, THE SLOW-DOWN IN THE RATE OF COST-PUSH INFLATION SHOULD IMPROVE THE COMPETITIVE POSITION OF BRITISH EXPORTS IN WORLD MARKETS.

4. WITH REGARD TO THE OUTLOOK FOR PARTICULAR SECTORS, CONSUMER DURABLES AND CAPITAL GOODS SHOULD BE HARD HIT. UNTIL NOW, CAPITAL GOODS PRODUCERS HAVE BEEN PROTECTED FROM THE FULL BRUNT OF THE RECESSION BECAUSE THEY ARE STILL WORKING OFF LONG ORDER BACKLOGS BUILT UP DURING THE 1973 BOOM. THIS CUSHION IS NOW LARGELY GONE, AND THERE ARE FEW NEW ORDERS ON THE BOOKS OR ON THE IMMEDIATE HORIZON. THE DECLINE IN OUTPUT OF CONSUMER DURABLES IS BEING LED BY THE AUTOMOTIVE INDUSTRY AND CAN BE ATTRIBUTED TO DECLINING LEVELS OF REAL DISPOSABLE INCOME AND CHRONIC PRODUCTION DIFFICULTIES. RECENT INTEREST RATE RISES WILL PREJUDICE THE RATE OF ANY RECOVERY IN HOUSING AND CONSTRUCTION. WHILE ALL THESE ELEMENTS PROVIDE STRONG

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GROUND FOR PESSIMISM, THERE IS ONE OTHER FACTOR WHICH IS LIKELY TO PLAY A MODERATING ROLE, PARTICULARLY OVER THE NEXT TWO QUARTERS. THIS IS THE RATE AT WHICH MANUFACTURERS REBUILD INVENTORIES. PART OF THE EXPLANATION FOR THE DECLINE IN INDUSTRIAL PRODUCTION OVER THE PAST 6 MONTHS HAS BEEN THE RAPID DRAWING DOWN OF STOCKS OF MATERIALS AND FUELS. IN MANY INSTANCES, THESE HAVE BEEN DRAWN DOWN TO MINIMALLY ACCEPTABLE LEVELS. THE LAST SUR-

VEY OF BUSINESS INTENTIONS DONE BY THE CONFEDERATION OF
BRITISH INDUSTRY SHOWS A LESS NEGATIVE EXPECTATION ON THE
VALUE OF NEW ORDERS BETWEEN NOW AND NOVEMBER. THIS COULD
FORESHADOW THE RESTORATION OF MORE NORMAL INVENTORIES
LEVELS AND SLOW, TO SOME EXTENT, THE RATE OF DECLINE IN
OUTPUT.

5. THROUGH JUNE, THE TWO MAIN INDUSTRIAL PRODUCTION
INDEXES ARE AS FOLLOWS: (1970 EQUALS 100)

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ALL INDUSTRIES MANUFACTURING

1972	102.6	102.3
1973	110.2	110.9

1974	106.4	108.0
1975 - I	104.5	105.5
1975 - II	100.8	101.2
APRIL	101.9	102.5
MAY	100.5	100.6
JUNE	100.0	100.6

6. OUR ESTIMATE IS THAT THE THIRD AND FOURTH QUARTER STATISTICS WILL SHOW BOTH INDEXES CONTINUING THEIR DECLINE. HOWEVER, THE RATE OF DECLINE SHOULD BE MODERATED BY SOME STOCKBUILDING. AS A RESULT, THE FOURTH QUARTER

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FIGURE FOR THE ALL INDUSTRY INDEX SHOULD BE BETWEEN 98 AND 99 (1970 EQUALS 100) WITH THE FIGURE FOR MANUFACTURING ALONE ABOUT A POINT HIGHER. DURING THE FIRST QUARTER OF 1976, THE INDEXES SHOULD BEGIN TO RECOVER GRADUALLY SO THAT, BY THE END OF THE SECOND QUARTER, THEY SHOULD HAVE RETURNED TO SOMETHING APPROXIMATING THEIR PRESENT QUARTERLY LEVELS, 100.8 AND 101.2 RESPECTIVELY. THE SECOND HALF OF 1976 SHOULD SEE A QUICKENING IN THE PACE OF THE RECOVERY AS CONTROLS ON DOMESTIC INCOMES ARE EASED. BY THE FOURTH QUARTER OF 1976, WE EXPECT TO SEE THE INDEX FOR ALL INDUSTRY AT ABOUT 106 OR 107 AND THAT FOR MANUFACTURING AT 107 TO 108.

7. THESE ESTIMATES WILL LOOK WILDLY OPTIMISTIC SHOULD THE ANTI-INFLATION PROGRAM PROVE TO BE A FAILURE (SOMETHING FEW EXPECT). A TEPID RECOVERY IN THE US, JAPAN AND WESTERN EUROPE OR DETERIORATION IN THE UK'S TERMS OF TRADE BECAUSE OF SHARPLY RISING WORLD COMMODITY PRICES WOULD ALSO PLAY HAVOC WITH THESE ESTIMATES.

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